No. 5493.

IN THE

United States Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Lewis N. Merritt,
Appellant,
vs.
S. H. Peters,
Appellee.

APPELLANT'S BRIEF.

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STATEMENT OF FACTS.

This is an appeal from the final order and decree of the District Court for the Southern District of California, Southern Division, entered on the 12th day of March, 1928, in the matter of Lewis N. Merritt, bankrupt, dismissing the petition and application of the bankrupt for discharge, and denying said bankrupt a discharge in bankruptcy from his debts [Record, p. 73].

Lewis N. Merritt was on the first day of April, 1927, in the District Court aforesaid duly adjudicated a bankrupt [Record, p. 2]. The controversy herein arises from the failure of the bankrupt to schedule his interest, if any, in two automobiles, as well as certain pictures to which he had a right of selection after the death of his

father under the terms of the will of his mother, Annette W. Merritt, deceased. Under the terms of this will, the four children of Annette W. Merritt were entitled to select in the order of their ages two of said paintings, said bankrupt having third choice thereof; but that said choice could not be made, nor any possession of said paintings taken until after the death of the father of the bankrupt, Lewis J. Merritt, who is still living. [Record, pp. 32-33.]

The interest of the bankrupt in these pictures was of such slight value and the time that he might be entitled to come into possession of two of them by selection so uncertain that objections to discharge in regard to said pictures was practically abandoned and wholly ignored in the order of the court. [Record, p. 72.] Therefore, no further mention will be made in this brief with respect to the same.

The only real ground of objection on the part of the appellee is with respect to the two automobiles—one a Packard sedan and the other a Nash roadster. The facts and circumstances relating to these two automobiles are substantially as follows:

Approximately some six months prior to the filing of the petition in bankruptcy schedules, appellant, the bankrupt, had entered into conditional sales contracts for the purchase of said automobiles with the Lindley Motor Co. These contracts were in the usual form of conditional sales contracts adopted by the automobile dealers in California, and provided that no title should pass to the buyer until full and complete payment of the contract price had been made. [Record, pp. 63-70.] At the time the

schedules were sworn to and filed the automobiles were not in the possession of appellant. [Record, pp. 30, 47.]

The first meeting of the creditors was held on the 27th day of April, 1927, at which time the trustee was appointed. A motion was made by appellant's attorney for leave to amend the schedules to include any interest appellant might have in said two automobiles, and schedule A-2 was amended under date of May 3, 1927. [Record, p. 36.] The bankrupt was not called for examination before the referee until the 24th day of May, 1927 [Record, p. 40], at which examination it developed that the appellant was buying these two automobiles on conditional sales contracts, and that they were not in his possession either at the time of filing of the schedules nor on the 24th day of May, 1927, the first day of his examination. [Record, pp. 24-25.] It also developed at the same hearing that there was about $1600.00 due on the Packard. [Record, p. 24.] The amount due at that time upon the Nash is not shown in the record. Possession of the automobiles was reacquired by the appellant on or about the 1st day of July, 1927 [Record, p. 32], and he finally lost possession of the same to the Lindley Motor Co. on or about the 8th day of October, 1927. [Record, p. 32.]

Between the time appellant reacquired possession of the automobiles and the time he finally lost the possession, he had paid about $1000.00 on the installments. The cars finally came to the possession of the trustee on a turnover order, he paying to the holder of the conditional sales contracts about $1100.00, and the two cars sold for $2050.00. [Record, p. 54.]

The trustee knew of the existence of these automobiles, but took no action to find out whether they were in the possession of the appellant or the seller under the conditional sales contracts between the first meeting of the creditors on the 27th day of April, 1927, and early in October of that year. [Record, p. 35.] He knew that the amended schedule A-2 under date of May 3rd, 1927, had been filed. [Record, p. 36.] He asked his attorney to investigate the matter early in May, but nothing was done about it until the middle of October. [Record, p. 37.] The petition for discharge was referred to James L. Irwin, Esq., special master, and objections thereto were filed by appellee Peters. [Record, pp. 6-10.] A hearing was had and the master overruled the objections and exceptions and reported to the court recommending the bankrupt's discharge. [Record, pp. 11-14.]

Exceptions were filed, which came on for hearing before the Honorable Wm. P. James, District Judge, and the exceptions were sustained and appellant denied his discharge. [Record, pp. 14-18; Record, pp. 72-73.] The question involved in this case is whether or not there was a wilful and fraudulent concealment by the bankrupt from his trustee of these two automobiles, and whether or not the bankrupt was guilty of false swearing on the hearing before the referee on the 24th day of May, 1927.

ARGUMENT.

I.

Appellant at the Time He Filed His Schedules Had No Title to the Automobiles in Question.

Each of the automobiles in question were purchased from the Earl Lindley Motor Company under a con-

ditional sales contract [Record, pp. 63-70], in which contracts, among other things, it was provided that the buyer (appellant) "will not permit the same to be removed from his possession; to be attached or replevined, nor create nor permit to be created any lien or encumbrance against the same on account of claims against him or for storage, repairs, or otherwise."

It was further provided that he "should not sell, attempt to sell, lease, mortgage, hypothecate or otherwise dispose of said personal property * * * or any of his rights hereunder, and any assignment of this contract or any of the purchaser's rights hereunder by the purchaser or by execution or other legal process, or otherwise, or the transfer thereof by process of law or otherwise, shall, at the option of the seller, terminate all rights hereunder to purchase said personal property."

Further, "in the event that the purchaser shall become financially involved or insolvent, or shall be adjudicated a bankrupt * * * the seller at his option and without notice to the purchaser, may elect to declare the whole purchase price immediately due and payable, or the seller may without notice to the purchaser declare all of the rights of the purchaser under this contract terminated, and without demand first made, and with or without legal process, may take possession of said personal property, wherever found, using all necessary force so to do, and hold the same discharged from further liability under this contract. * * * In the event the seller elects to take possession of said personal property, all of the rights of the purchaser under this contract shall immediately terminate and all payments theretofore made hereunder shall belong absolutely to the seller."

It was further provided that "until the purchaser has fully complied with all the terms, covenants and conditions of this contract, and made all of the payments as hereunder provided, said personal property, including all parts, accessories and equipment now or hereafter attached to or used in connection with said personal property shall belong to, and the title to said personal property shall remain in the seller. Possession of said personal property shall give the purchaser no title or interest therein and no rights except as herein provided. If the purchaser shall fully comply with all of the terms, covenants and conditions of this contract, and make all of the payments as herein provided, the seller agrees to give a bill of sale of said personal property to the purchaser and convey title to him."

It was further provided therein "time and each of its terms, covenants and conditions are hereby declared to be of the essence of this contract, and acceptance by the seller of any payment hereunder, after the same is due, shall not constitute a waiver by him of this or any other provision of this contract."

And that "this contract may not be enlarged, modified or altered except by endorsement hereon and signed by the parties hereto."

II.

Appellant at the Time He Filed His Schedules Had No Equity in the Automobiles in Question.

The value of the Packard car on the first of April, 1927, was about $1100.00; the balance due on it was $1016.76. The Nash car was worth about $950.00 and there was $976.56 due April 1st, 1927. [Record, p. 60.]

Some time after May 24 appellant regained possession of the automobiles and from that time down until they were finally taken from him paid about $1000.00 thereon. The cars were sold by the trustee and he realized for the estate about $900.00. [Record, p. 54.]

III.

The Automobiles in Question Were Not in His Possession at the Time the Schedules Were Signed and Filed.

They were repossessed by the seller on four different occasions. The first time was before the first of April, 1927. [Record, p. 57.] They had been out of his possession for about two weeks [Record, p. 47], and were in the warehouse of the Lindley Motor Co. in Pasadena on the 24th of May, 1927 [Record, p. 22], the day of appellant's first examination.

IV.

The Failure of Appellant to Schedule in the First Instance Was Upon the Advice of Counsel.

> "Q. By the way, what was the reason you didn't schedule the cars in the petition in the first place? A. I was advised that I had no equity in them.
>
> Q. Who advised you that? A. Mr. Morris.
>
> Q. Was he your attorney at that time. A. Yes. sir." [Record, p. 49.]

> "At the time I verified these schedules I had a conversation with my attorney relative to the automobiles. I don't remember just what I said to him, but he said that I had no equity in them and that they did not belong to me. I do not know that my defense is that I made a full and fair disclosure to my attorney. I don't remember what he said. He simply

said that they didn't belong to me; that I had no right to schedule them. I told him that I wanted to turn in everything I had and that I had these on sales contract. I did not tell him where they were. When we drew up the schedules I didn't know myself where they were. I told him the truth about them and I don't know now, at that date, what it was." [Record, p. 52.]

"Q. It was not a case on your part of forgetting the cars. That was the reason why they were not listed; you knew you had them? A. I could not tell because in the contract it said I had no rights and that they were not my property, and I was at a loss about it and I simply left it up to my attorney.

Q. But you don't remember what you told your attorney? A. I don't remember the exact conversation, no." [Record, p. 59.]

It is very apparent from this testimony that appellant gave his attorney as full information concerning the automobiles as a layman could, and after having made such full disclosure, and acting on the advice of his attorney, he failed to schedule the automobiles, there certainly can be no element of fraud charged to him by that act.

V.

Appellant Acted in Good Faith and Was Guilty of No Fraud.

Conditional sales contracts are recognized in this state to the fullest extent.

Van Allen v. Francis, 123 Calif. 474;

Oakland Bank v. Calif. Pressed Brick Co., 183 Calif. 295.

Whether a contract is one of conditional sale or of absolute sale, with reservation of title as security only, is to be determined by the law of the state where it is to be performed, and the decisions of the highest court of that state as to the construction of such a contract is binding on the bankrupt court.

Matter of Nader, 276 Federal 123.

Where under the state law the title to chattels sold may be retained by the seller pending full payment of the purchase price, and such reservation is good as against creditors, it is also good as against the trustee in bankruptcy of the buyer.

Matter of Farmers' Dairy Association, 234 Federal 118.

While it is true that the amendment of section 47 of the Bankrupt Act, which gave the trustee of the bankrupt "the rights, remedies and powers of a creditor, holding a lien by legal or equitable proceedings," it did not give the trustee the status of an innocent purchaser. He has no greater right than a judgment creditor.

A trustee in bankruptcy gets no better title than that which the bankrupt had and is not a subsequent purchaser, in good faith, within the meaning of section 112 of chapter 418 of the laws of 1897 of New York. And as the vendor's title under a conditional sale is good against the bankrupt, it is good also against the trustee.

Hewit v. Berlin Machine Works, 194 U. S. 296.

Inasmuch as by the law of the state of California, as construed by its Supreme Court, conditional sales contracts have been sustained to the fullest extent, the decisions above cited are authority for the contention we

are now making here. The bankrupt had no title. That was specifically reserved to the vendor. He had no interest which he could convey. He had a mere right of possession, and that is all. As we read it, that was held in the case of King v. Klein, 49 Calif. App. 696, where the court said "that the vendee under a contract of conditional sale acquired a defeasible interest in the property," and that is so even though a creditor might be placed in the shoes of the vendee upon tendering performance of all of the obligations of the vendee, an act which the creditor or the trustee in bankruptcy might perform without the assistance of the bankrupt (or vendee). Indeed, in the case at bar, had the bankrupt scheduled the automobiles in question that would immediately have been a violation of his agreement with the vendor and opened the door immediately for the vendor to repossess the cars, but would not have relieved the bankrupt of his obligation to make further payments on his contract. If by scheduling the automobiles the bankrupt thereby immediately lost his right of possession and gave the vendor the option to reclaim the cars at once, how can it be said that in scheduling the cars something of value would have passed to the trustee? Because it must be remembered that the absolute title vested in the vendor and that all payments made by the vendee up to that time would be forfeited and lost not only to the bankrupt but to his trustee.

This question was considered carefully by the bankrupt's attorney when the schedules were being made, and the court must assume that any lawyer in California would know, upon learning that these cars were held under a conditional sales contract, that there was neither title nor

equity in the cars which could pass to the trustee. Indeed, any layman of average intelligence, having entered into contracts like the two in question, must be presumed to have read the same and know their contents and could have come to no other conclusion himself than that until he had fully paid the contract price he had nothing but the right of possession, and, in our view, it makes no difference whether Mr. Merritt was able to disclose to the special master or not all that was said at the time the question of the scheduling of the automobiles was under consideration. There is certainly nothing in the record to show that the matter was not given consideration, and the advice which was given to him at that time, we respectfully submit, was a sufficient justification for his failure to so schedule them and is a refutation of the charge that there was a fraudulent concealment, and this is true whether the automobiles were in or out of the possession of the bankrupt at the time. There is no dispute that he lost possession of the cars on four different occasions, and there is no serious dispute that when he gave his testimony on the 24th of May, 1927, the cars were not in his possession, but, as we have above said, even though they were, the failure to schedule them was not done with any fraudulent intent. As was said by the special master [Record, pp. 54-55], "The fact that a man fails to schedule two automobiles, the title to which it might take a skilled lawyer to decide, or whether he really had any equity in the cars, is probably not sufficient ground to deny the discharge. * * * A great many lawyers might have advised the bankrupt not to schedule them. This is not such a concealment of assets as would be sufficient grounds for the denial of a discharge, as I see it at this time."

Again [Record, p. 61], the special master at the close of the hearing said, "I do not see anything to cause me to change my views as expressed yesterday. The only question is whether there is bad faith in not scheduling these automobiles and certain paintings, and, as I stated, a reasonably prudent man, or even attorneys, might differ whether property held on contract, that has already been returned, need be scheduled. This bankrupt did not have the title to these automobiles, as I understand it; they were not registered in his name. * * * He had no claim on the title. He might have had a very inconsequential equity in their value, but as it turned out, he had no equitable value, and apparently the trustee did not think there was any equity; and Mr. Moore is a very careful man, and he usually takes hold of everything that he thinks has any value; but he let it go on for months here until the bankrupt made more payments, making the cars more valuable to the estate, and then he took possession of them and sold them for only the amount that the bankrupt had paid on them since they were repossessed. So I can see no bad faith in not scheduling these automobiles. It probably would have been better practice to schedule them. * * * The whole thing hinges on whether there was any agreement between Mr. McDonald of the Finance Company or the Lindley Motor Company to return them; but the objecting creditor has made no attempt to show that."

While it is true that the learned judge took a different view of the case and decided adversely to appellant, we have not, however, been favored with any opinion—simply an order holding that the failure to schedule was fraudulent and denying the discharge. While it may be

true that the appellate court is not bound to give consideration to the views of the special master where they are in conflict with the views of the district judge, yet we contend that the referee in bankruptcy, who is in daily contact with witnesses and bankrupts, familiar with efforts at evasion of the law, skilled in observing the demeanor of witnesses who appear before him, is in a better position to sift the facts and get nearer to a true conclusion upon a question of good faith than the court with nothing but cold print before him. The referee, sitting as a special master, heard this particular controversy and had also heard the prior testimony of appellant when examined before him as referee, and had full opportunity to judge the character and demeanor of the witness.

Furthermore, the subsequent scheduling of the automobiles was allowed on the application of the bankrupt made before any question with respect to them had been raised. The first meeting of the creditors was held April 27th, 1927, at which time Mr. Moore was elected trustee. The bankrupt was first examined on May 24th, 1927. The automobiles were out of the possession of the bankrupt. He had lost his rights and his counsel upon reflection decided to give the trustee the opportunity to get something out of the cars if he could.

The bankrupt is not a business man. The examination of this record will disclose that he was trying to remember the facts and give them to the master according to his best recollection. I hold no brief for a bankrupt who attempts to evade the law, and will give no aid to one who seeks to perpetrate a fraud. This whole controversy arises by reason of the fact that the writer of this brief, in order to remove the shadow of a suspicion of an at-

tempt to evade the law, advised appellant to amend his schedule. This advice was given subsequent to that given by Mr. Morris, and after the schedules had been filed. It may not have been the wisest course to pursue. Appellant may be the victim of conflicting legal opinions, but the outstanding fact in this record is that he took the advice of each of his lawyers at the time the same was given, and acted on such advice. Surely it would be a harsh rule to invoke against appellant that he should be held to have committed a fraud when he was trying by the only way known to honestly follow the advice of his counsel. The learned district judge fell into a grave error, and the order and decree denying appellant's discharge should be reversed.

All of which is respectfully submitted.

NICHOLAS W. HACKER,
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